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UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Communications
and Information
Washington, D.C. 20230

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Federal Communications Commission
Office of Secretary

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Federal-State Joint Board on Universal Service
CC Docket No. 96-45

Dear Chairman Hundt,

I want to thank you and the other members of the Joint Board for inviting the Administration to present our E-rate plan on October 17, 1996. We were pleased by the positive comments of the Board with respect to the framework of the plan and the need to ensure that all schools and libraries have access to a basic package of services as well as the opportunity to obtain and use an advanced network of services on a sustained basis. We stand ready to answer any questions that you may have about the plan and to work through the details that would ensure its adoption and success.

In addition to the decision that you must reach on the E-rate, you are also faced with important and complex questions concerning universal service generally. The Administration has been and continues to be committed to the preservation and enhancement of universal service for all Americans. In the past year, NTIA has submitted to the Commission and the Joint Board two major pleadings discussing universal service issues and telephone subscribership generally. To again highlight our concern with respect to these crucial issues, I have enclosed copies of both prior pleadings, along with a separate paper summarizing the pleadings' principal policy recommendations for your consideration.

Although the United States has made great strides in realizing the universal service goal, there are nevertheless some 6 million households today that do not have telephone service. There also remain significant disparities in telephone penetration among households by income, race and ethnicity, level of education, and geography. It is thus imperative that the Joint Board devise effective and targeted support mechanisms to ensure the affordability of telephone service for these and other underserved segments of our society.

The Joint Board must also ensure that the universal service package to be made available and affordable to all Americans can evolve with changing technology and consumer demand. Voice grade service may today be sufficient to allow subscribers to communicate among themselves and to sample the growing range of information services available to them

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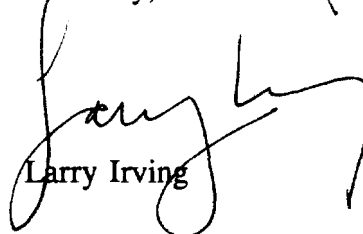
The Honorable Reed E. Hundt
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via the Internet and other sources. In the future, however, new capabilities and services will likely be needed to give households a full and fair opportunity to enjoy the riches of the Information Age. The Joint Board's policies must ensure that when such capabilities and services become essential, they will be universally available.

Finally, as the Commission and the Joint Board facilitate the transition from a regulated, monopoly-based industry to a competitive environment by realigning cost with price, we must ensure that American consumers are not adversely affected. Universal service support for low-income and high-cost areas must be preserved and any rate-shock avoided.

As the Joint Board grapples with the many important issues highlighted in this letter, the enclosed pleadings and summary are again presented for your consideration. I would be happy to discuss these further with you or with any of your colleagues on the Joint Board in the coming weeks.

Sincerely,



Larry Irving

Enclosures

cc: Commissioner Rachelle B. Chong
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Commissioner Julia L. Johnson, Florida
Public Service Commission
Commissioner Kenneth McClure, Missouri
Public Service Commission
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Martha S. Hogerty, Public Counsel for the
State of Missouri
Commissioner Laska Schoenfelder, South Dakota
Public Utilities Commission

SYNOPSIS OF NTIA FILINGS
ON UNIVERSAL SERVICE ISSUES

Re: NTIA Reply Comments filed in CC Docket Nos. 95-115 and 96-45,
Amendment of the Commission's Rules and Regulations to Increase Subscribership
and Usage of the Public Switched Network and Federal-State Joint Board on
Universal Service, respectively

A. SUBSCRIBERSHIP [Reply Comments filed March 29, 1996, Dkt. 95-115]

- The Commission should establish a National Subscribership Goal so that by the year 2000, within each state, average telephone penetration rates for all households, including certain designated economic, racial, ethnic, and geographic categories, will be at or above the national average that exists as of November 1996. [See Reply Comments at 4-8]
- States should have broad latitude to implement policies and programs designed to achieve the National Subscribership Goal (such as a ban on the disconnection of local service for nonpayment of long distance charges). If the national goal has not been achieved by the year 2000, the Commission should assess whether Federal action is needed to accomplish that goal. [See Reply Comments at 8-10]

B. UNIVERSAL SERVICE POLICIES [Reply Comments filed June 12, 1996, Dkt. 96-95]

- The Federally-defined universal service package should ensure the provision a single voice grade line to residential customers. The basic package should also include: touch tone dialing and a reasonable amount of free usage; access to toll, emergency, and relay services; access to repair services and directory and operator assistance; and privacy protections, including caller ID with blocking options. [See Reply Comments at 6-9]
- The Commission should convene a Joint Board to assess the adequacy of the Federally-defined universal service package every three years. The Commission should consider instituting more frequent reviews in response to petitions from interested parties. [See Reply Comments at 8 n.18]
- Low income households meeting a State-determined means test should be eligible for support from the Federal universal service fund (up to the full amount of the subscriber line charge), if the relevant State provides reductions in intrastate charges that equal or exceed 25 percent of the Federal support. [See Reply Comments at 12-15]

- Eligible companies whose costs exceed 130 percent of the national average should be entitled to receive, for each customer served, high cost support equivalent to the difference between the companies' actual costs and 130 percent of the national average. Company costs should be determined by some objective benchmark. [See Reply Comments at 15-19]
- States ought to have latitude to establish their own competitively neutral mechanisms for furnishing low income and high cost support. States should also be allowed to create transitional support mechanisms to mitigate any "rate shock" caused by the alignment of prices with underlying costs. [See Reply Comments at 19-21]
- All providers of interstate telecommunications services should contribute to the Federal universal service fund, based on a percentage of their interstate revenues (less payments for interstate telecommunications services purchased from companies that also contribute to the Federal fund). [See Reply Comments at 22-25]
- The Commission should construe the term "eligible telecommunications carrier" (ETC) to maximize the number of firms eligible to receive Federal universal service support, thus encouraging competition. Federal support should be given to ETCs based solely on the number of customers served, thereby making it easier for ETCs to compete for customers. [See Reply Comments at 25-28]

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

JUN 12 1996

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

REPLY COMMENTS OF THE
NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION

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June 12, 1996

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EXHIBIT

Estimated Cost Profiles for Connecting Schools and Libraries to Advanced Networks

SUMMARY

In fashioning new universal service policies, the Commission and the States must ensure that those policies are consistent with the Act's mandate to foster meaningful competition in every segment of the telecommunications marketplace in all U.S. jurisdictions. Competition clearly furthers universal service goals, because it tends over time to reduce prices, spur innovation, and expand the range of available services. This is true, however, only if the nation's universal service policies permit the competitive process to operate effectively.

In NTIA's view, these policies require, at a minimum, that the rates for the Federally defined universal service package should reflect the economically relevant costs of providing it. All subsidies needed to preserve the affordability of service to all Americans should be explicit and narrowly targeted to avoid sending the market "false" signals that may deter efficient entry in some areas and attract inefficient entry in others. Moreover, such subsidies must be collected and, as importantly, disbursed in a competitively neutral manner.

NTIA recommends that the Commission and the Joint Board define a dynamic universal service package for residential subscribers that for now is predicated, as suggested in the Notice, on voice grade access to the public switched telephone network. The Commission should continue its Lifeline program as the Federal mechanism for providing support to low-income

families, with the following modification: households satisfying a State-defined means test should be eligible for Federal support (up to the full amount of the Federal subscriber line charge), provided that the State reduces intrastate service charges in an amount equal to or greater than 25 percent of the Federal support.

The Commission and the Joint Board should also provide for Federal support to areas where the cost of providing the universal service package, objectively quantified, exceeds 130 percent of the national average. Eligible companies serving those areas would be entitled to receive, for each customer served, an amount from the Federal universal service fund equal to the difference between their costs of service (objectively determined) and 130 percent of the national average. The Commission and the Joint Board could phase-in this modified high cost support program over several years. State commissions should be encouraged to adopt independent support mechanisms to furnish additional support to low-income households and high costs areas, as well as to mitigate any potential rate shocks, although we do not anticipate widespread rate shock.

The Commission and the Joint Board should require all providers of interstate telecommunications services to contribute to the Federally established universal service fund. That contribution should take the form of a percentage surcharge on

their interstate retail revenues, minus any payments for telecommunications services received from other companies who also pay monies into the Federal fund. Further, the Commission and the States should construe the Act to maximize the number of firms that can be designated as ETCs, thereby promoting greater competition. In addition, ETCs should receive universal service support based on the number of subscribers served. The Federal fund should be administered by an independent entity selected by competitive bidding.

Finally, with respect to schools and libraries, the Snowe-Rockefeller amendment to the Act presents a timely opportunity to ensure that the nation's schools and libraries can participate fully in the burgeoning Information Age. A review of some available cost studies conducted by NTIA suggests that the costs of connecting those institutions represents a relatively low percentage of the total expenditures needed to give schools and libraries full use of the Information Highway and all the information resources available through it. Thus, contrary to some fears, the universal service funding required to support the discounted portion of those connection costs would not be excessive.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)
) CC Docket No. 96-45
Federal-State Joint Board on)
Universal Service)

REPLY COMMENTS OF THE
NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION

The National Telecommunications and Information Administration (NTIA), an Executive Branch agency within the Department of Commerce, is the President's principal advisor on domestic and international telecommunications and information policy. NTIA respectfully submits these Reply Comments to the comments submitted in response to the Commission's Notice of Proposed Rulemaking and Order Establishing Joint Board (Notice) in the above-captioned proceeding.¹

I. INTRODUCTION

The Telecommunications Act of 1996 requires the Commission, based on recommendations from a Federal-State Joint Board (Joint Board), to issue an Order within fifteen months making fundamental changes in the nation's current policies for

1/ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 96-93 (released Mar. 8, 1996) [hereinafter Notice]. Unless otherwise indicated, all subsequent citations to "Comments" shall refer to pleadings filed on April 12, 1996 in CC Docket No. 96-45.

preserving and advancing universal telephone service.² The Commission must for the first time define a national universal service package to be made available and affordable to all Americans.³ The Commission must also create mechanisms to: (1) collect universal service support funds from providers of interstate telecommunications services,⁴ (2) disburse those funds to eligible telecommunications carriers (ETCs),⁵ and (3) by so doing, ensure the affordability of the Federally defined universal service package to low-income consumers and consumers in rural, insular, and high cost areas.⁶ Finally, through the efforts of Senators Snowe, Rockefeller, and others, the Act requires the Commission to adopt policies to give schools, libraries, and rural health care providers access to telecommunications and information services at preferential rates.⁷

2/ Telecommunications Act of 1996, Pub. L. No. 104-104, § 254(a)(2), 110 Stat. 56 (Act) (to be codified at 47 U.S.C. §§ 151 et seq.) [hereinafter Act]. For convenience, all references to the Act in this pleading will cite to the section numbers that will apply after the Act's provisions have been codified in the United States Code.

3/ Id. § 254(a)(2), (c).

4/ Id. § 254(d).

5/ Id. §§ 254(e), 214(e).

6/ Id. § 254(b)(3).

7/ Id. § 254(h)(1), (2).

States and State regulatory commissions will also play a major role in this process. Through their participation on the Joint Board, States will exert considerable influence over the Federal universal service policies that the Commission ultimately prescribes. As importantly, the Act specifically authorizes States to adopt universal service definitions and standards over and above the Federal minimums, so long as the State initiatives are not inconsistent with the national requirements and the States create "additional specific, predictable and sufficient mechanisms [based on intrastate revenues] to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms."¹ Thus, in the area of universal service, as in other parts of the Act, Federal/State collaboration is essential if we are to realize the full benefits of the Act's design.²

In fashioning new universal service policies, the Commission and the States must ensure that those policies are consistent with the Act's mandate to foster meaningful competition in every segment of the telecommunications marketplace in all U.S.

8/ Id. § 254(f). Because of the considerable revenues associated with intrastate services, the potential support funds established by State commissions will most likely, in total, surpass the Federal universal service fund by a substantial margin.

2/ Cf. Reply Comments of NTIA in CC Docket No. 96-98, at 2-5 (filed May 30, 1996) (noting the importance of a joint Federal/State effort with respect to interconnection and unbundling).

jurisdictions. Competition clearly furthers universal service goals, because it tends over time to reduce prices, spur innovation, and expand the range of available services. The converse will be true, however, only if the nation's universal service policies permit the competitive process to operate effectively.

In NTIA's view, this requires, at a minimum, that rates for the Federally defined universal service package should reflect the economically relevant costs of providing it. All subsidies needed to preserve the affordability of service to all Americans should be explicit and narrowly targeted to avoid sending the market "false" signals that may deter efficient entry in some areas and attract inefficient entry in others. Moreover, such subsidies must be collected and, as importantly, disbursed in a competitively neutral manner.

NTIA recommends that the Commission and the Joint Board define a dynamic universal service package for residential subscribers that for now is predicated, as suggested in the Notice, on voice grade access to the public switched telephone network. The Commission should continue its Lifeline program as the Federal mechanism for providing support to low-income families, with the following modification: households satisfying a State-defined means test should be eligible for Federal support (up to the full amount of the Federal subscriber line charge),

provided that the State reduces intrastate service charges in an amount equal to or greater than 25 percent of the Federal support.

The Commission and the Joint Board should also provide for Federal support to areas where the cost of providing the universal service package, objectively quantified, exceeds 130 percent of the national average. Eligible companies serving those areas would be entitled to receive, for each customer served, an amount from the Federal universal service fund equal to the difference between their costs of service (objectively determined) and 130 percent of the national average. The Commission and the Joint Board could phase-in this modified high cost support program over several years. State commissions should be encouraged to adopt independent support mechanisms to furnish additional support to low-income households and high costs areas, as well as to mitigate any potential rate shock, although we do not anticipate widespread rate shock.

The Commission and the Joint Board should require all providers of interstate telecommunications services to contribute to the Federally established universal service fund. That contribution should take the form of a percentage surcharge on their interstate retail revenues, minus any payments for telecommunications services received from other companies who also pay monies into the Federal fund. Further, the Commission

and the States should construe the Act to maximize the number of firms that can be designated as ETCs, thereby promoting greater competition. In addition, ETCs should receive universal service support based on the number of subscribers served. The Federal fund should be administered by an independent entity selected by competitive bidding.

Finally, with respect to schools and libraries, the Snowe-Rockefeller amendment to the Act presents a timely opportunity to ensure that the nation's schools and libraries can participate fully in the burgeoning Information Age.¹⁰ An analysis conducted by NTIA suggests that the costs of connecting those institutions represents a relatively low percentage of the total expenditures needed to give schools and libraries full use of the Information Highway and all the information resources available through it. Thus, contrary to some fears, the universal service funding required to support the discounted portion of those connection costs would not be excessive.

II. THE PACKAGE OF SUPPORTED SERVICES SHOULD BE "BASIC," YET DYNAMIC

The Act requires the Commission to define a universal service package that will be "supported by Federal universal service support mechanisms."¹¹ In NTIA's view, the Joint Board

¹⁰/ See Act § 254(h).

¹¹/ Id. § 254(a)(1), (2).

should recommend that the Commission adopt a basic core of telecommunications services founded on voice grade access to the public switched telephone network.¹² Initially, the Federally established universal service package should include the following:¹³

- Access to voice-grade service with touch tone dialing and some level of local usage;¹⁴
- Access to toll services;
- Access to emergency services;
- Access to directory assistance, operator assistance, and repair service;
- Access to statewide relay services;
- "White pages" directory listings; and
- Privacy protections, including caller ID with blocking options.¹⁵

Each of the foregoing elements satisfies the four criteria identified in the Act for determining whether a service or feature should be included in the Federal universal service

^{12/} Many commenters concur with this position. See, e.g., Comments of the United States Telephone Ass'n at 12-14 (USTA); Comments of US West at 5-6; Comments of AT&T Corp. at 11-14 (AT&T).

^{13/} The Joint Board should also recommend that the Commission adopt minimum service quality standards for the services and capabilities included within the universal service package. See Comments of the United States Telephone Ass'n at 2-4 (USTA); Comments of MCI Telecommunications Corp. at 21-22 (MCI).

^{14/} Subscribers to the basic universal service package must receive more than the opportunity to make calls. Defining the package as a measured service offering might be workable if the package includes a reasonable amount of free usage.

^{15/} See Comments of the New York State Consumer Protection Board at 2, 7-8 (such services offer important protections to subscribers yet "are not expensive to provide and their inclusion would not place undue pressure on telecommunications prices").

package.¹⁶ Together, these elements will provide the basic, reliable functionality necessary for households to place and receive the full range of voice telephone calls. For households with computers and modems, moreover, the basic package can furnish an effective and versatile pathway to the Information Age, including the Internet and other information networks.¹⁷ As consumer demand grows for future telecommunications and information services, the Commission should reevaluate the universal service package.¹⁸ This will ensure that all Americans have full and fair access to advanced services.

NTIA believes that the Federally defined universal service package would be best targeted to single-line service for

^{16/} See Act § 254(c)(1). See also Comments of the National Cable Television Ass'n, Inc. at 4-5 (NCTA).

^{17/} Furthermore, NTIA's proposed definition of the universal service package will promote competition by enabling more new entrants to qualify as ETCs, thereby becoming eligible to receive necessary support in order to compete better against incumbent ETCs. See Section IV.B, *infra*.

^{18/} Act § 254(c)(1)(B). The Act provides that the Joint Board "may, from time to time, recommend to the Commission modifications" in the Federally defined universal service package. *Id.* § 254(c)(2). The Clinton Administration remains committed to a vision of a National Information Infrastructure (NII) that provides to all Americans connections to advanced information networks and resources. To ensure regular review of the Federal universal service definition, NTIA suggests that the Commission convene a Joint Board for that purpose every three years. To minimize the risk that triennial reviews of the universal service definition do not keep pace with the rapidly changing telecommunication landscape, the Commission could consider instituting more frequent reviews in response to petitions from interested parties.

residential customers,¹⁹ with any universal support for business customers to be provided by the States.²⁰ Because the costs of telephone service are likely to be a small fraction of total operating costs for most businesses, affordability of service should generally not be a problem for business users.²¹ In addition, guaranteeing the availability and affordability of the universal service package for business customers would greatly expand the amount of support required. That would, in turn, heighten the risk of unintended and potentially adverse effects,²² increase the burden on the carriers who must generate support funds (and their customers),²³ and enlarge the social welfare losses that any subsidy mechanism -- however well-crafted -- causes.²⁴

^{19/} See, e.g., Comments of AT&T at 11-14; Comments of Bell Atlantic at 6-8.

^{20/} We think that universal service support for business customers should be left to the States not only because they are more familiar with the needs of the companies within their jurisdictions, but also because those needs probably vary from State to State. Of course, States are completely free under the Act to provide subsidized service to businesses or any other group of customers if they develop "specific, predictable, and sufficient mechanisms" to provide the necessary funding that neither rely on nor burden Federal mechanisms. Act § 254(f).

^{21/} Comments of MCI at 9; Comments of Florida Public Service Comm'n at 6 (Florida).

^{22/} Comments of MCI at 9.

^{23/} Comments of Citizens for a Sound Economy at 6.

^{24/} See Comments of AirTouch Communications, Inc. at 6-7.

III. ENSURING JUST, REASONABLE, AND AFFORDABLE RATES FOR ALL RESIDENTIAL SUBSCRIBERS

As noted above, competition and universal service are compatible, not conflicting.²⁵ In order to promote a competitive market, however, prices must be aligned with cost. Because cost-based prices both facilitate efficient competitive entry and lead to increased consumer welfare over the long term, the Joint Board and the Commission should conclude that such prices are just and reasonable under the Act.²⁶

They also should not be overly concerned that movement toward cost-based pricing may cause short-term increases in basic telephone rates. The notion that basic rates are currently priced below costs appears to be based largely on company-reported, historical costs. Equating prices with historical costs, however, is not only inconsistent with economic efficiency,²⁷ it is also largely irrelevant in an increasingly

25/ See, e.g., Comments of MFS Communications Co. at 2-5 (MFS); Comments of the California Department of Consumer Affairs at 6-7.

26/ See Act § 254(b)(1) (requiring that rates must be "just, reasonable, and affordable"). For a brief discussion of why cost-based rates promote both competition and social welfare, see Reply Comments of NTIA in CC Docket No. 96-98, at 16-17 (filed May 30, 1996); National Telecommunications and Information Admin., U.S. Dep't of Commerce, The NTIA Infrastructure Report: Telecommunications in the Age of Information, NTIA Special Pub. No. 91-26, at 280-281 (Oct. 1991).

27/ See Alfred Kahn and William Shew, Current Issues in Telecommunications Regulation: Pricing, 4 Yale J. on Reg. 191, 224 (1987) ("Economically efficient pricing looks not to the past -- not to how we got where we are -- but to the future; efficiency requires that prices tell customers what incremental resources society will use if they take more of the good or

competitive market. In NTIA's view, an appropriate forward-looking assessment of costs should result in rates for basic residential service that generally are not below costs.²¹

The Joint Board and the Commission could reasonably conclude that cost-based rates for the Federally defined universal service package will also be "affordable" for the vast majority of American households. As of 1994, the average American household devoted some 2 percent of its annual expenditures to telephone service, a figure that has remained steady for more than a decade.²² That percentage represents dollars spent on a wide range of services beyond local service, including long distance calling, directory assistance calls, connection charges, touch-tone, "vertical services" (such as call waiting and call forwarding), inside wiring maintenance, and even 900 services.²³ At this expenditure level, average telephone

service in question, what resources society will save if they consume less of it.") (emphasis in original).

28/ See, e.g., Comments of AT&T at 1-3; Comments of MFS at 5-7 (decrying the "myth" of subsidized local telephone service). In cases where aligning prices with relevant costs could foreseeably threaten universal service goals, the Act authorizes the Commission and the States to fashion support mechanisms to minimize harm to subscribers. NTIA discusses three such mechanisms in Sections III. A-C, infra.

29/ Industry Analysis Division, Federal Communications Comm'n., Trends in Telephone Service Table 9 (May 1996).

30/ See id. Charges for local telephone service (which average about \$19 per month nationwide) comprise less than one-third of the typical household's total telephone expenditures. Id. Tables 6, 9.

penetration for households in all income categories above \$20,000 is at or above the national average telephone penetration of 93.9 percent.³¹ These numbers suggest that affordability of basic telephone service is not a problem for most U.S. households.

A. Cost Support for Low Income Consumers

The same cannot be said for low-income households, however. As compared with the national penetration average,³² subscribership among central city households earning \$10,000 or less per year is only 79.8 percent.³³ Rural households earning equivalent amounts did not fare much better at 81.6 percent.³⁴ Furthermore, the poorest American households (those in the lowest income quintile) currently devote 3.2 percent of their annual expenditures to telephone service, 50 percent more than the

31/ Alexander Belinfante, Industry Analysis Division, Federal Communications Comm'n, Telephone Subscribership in the United States at 5, Table 1 and 23, Table 4 (Feb. 1996) (using data through November 1995).

32/ Id. at 5, Table 1.

33/ Jim McConnaughey and Cynthia Nila, NTIA, Falling Through the Net: A Survey of "Have Nots" in Rural and Urban America Table 1 (July 1995).

34/ Id. NTIA's reply comments in the Commission's subscribership proceeding provide more detailed documentation of the extent to which poor families lack basic telephone service. Reply Comments of NTIA in CC Docket No. 95-115, at 5-7 and App. B (filed Mar. 29, 1996). We recommended there, and we reiterate here, that the Commission should adopt a National Subscribership Goal to ensure that, by the end of the year 2000, telephone penetration among low-income and other presently underserved households would be greater than or equal to the current national average. Id. at 7-8.

average household (2.1 percent) and twice as much as households in the highest income quintile (1.6 percent).³⁵

These statistics demonstrate the difficulties that low-income households have in affording basic telephone service. It is no surprise, then, that Congress specifically listed such households among the groups that warrant assistance to ensure their access to affordable telephone service.³⁶ Congress also identified the Commission's Lifeline program as a workable mechanism for distributing universal service assistance to low-income families.³⁷ Under the most commonly used Lifeline program, residential subscribers that satisfy a State-determined means test become eligible for a waiver of the entire Federal subscriber line charge (SLC), provided that a State makes matching reductions in the households' intrastate charges. Thus, if the State's contribution fully matches the Federal waiver, qualified households can receive rate reductions equalling twice the SLC.³⁸ Local exchange carriers receive universal service

^{35/} These figures are derived from the Bureau of Labor Statistics' annual Consumer Expenditures Survey.

^{36/} Act § 254(b)(3). See also H.R. Conf. Rep. No. 104-458, 104th Cong., 2nd Sess., reprinted in 1996 U.S.C.C.A.N. 124, 131 [hereinafter Joint Explanatory Statement].

^{37/} Act § 254(j).

^{38/} Thirty-eight states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands currently participate in this program. Only California presently participates in the Commission's other Lifeline program, which gives qualified households up to a 50 percent reduction in the SLC if a state provides matching reductions.

support funds equal to the amount of the SLC waived for each customer served.

NTIA believes that Federal universal service support should continue to be directed to low-income households via the Lifeline program.^{39/} Because the Act appears to contemplate Federal support for such households whether or not State commissions offer similar assistance,^{40/} there is a question whether the current program should be modified to eliminate its matching requirement. On the one hand, removal of that requirement would mean SLC relief for all poor families regardless of whether their State participates in the Lifeline program. On the other hand, the absence of a matching component could reduce some States' incentives to continue providing additional support to low-income households. On balance, NTIA favors a modified approach under which all households that meet a State-determined means test would receive support from the new Federal universal service fund (up to the full amount of the SLC), if the State provides

^{39/} The Commission also has its Link-Up America program, which helps defray telephone installation charges for low-income families. That program currently dispenses about \$20 million in assistance annually to households in every State, except California and Delaware as well as the District of Columbia and certain territories. See National Exchange Carrier Ass'n, 1995 Filing Update with the FCC (Nov. 20, 1995). The Link-Up program should also continue to be supported from the new Federal universal service fund.

^{40/} See Act § 254(a)(1), (2).

reductions in intrastate service charges that equal or exceed 25 percent of the Federal support.⁴¹

B. Cost Support for Consumers in High Cost Areas

The Act also indicates that Federal universal service support should be made available to high cost areas.⁴² Due to small and scattered populations, rugged terrain and other factors, the costs of serving some areas (especially rural areas) may be several times greater than the costs of provisioning more densely populated communities. In those circumstances, cost-based rates could impose considerable hardship on many of the households within those areas.

Although the Commission should continue to provide universal service support to high cost areas, it should substantially revise the mechanisms through which it currently distributes such

^{41/} Under this plan, a low-income household would be relieved of the entire SLC if the relevant State provides intrastate low-income support at least equalling one-quarter of the SLC. Needless to say, States could choose to provide even more support to low-income households.

Furthermore, States or their agents should undertake educational activities to promote awareness of such support for eligible households. Studies have shown that those without telephones often lack knowledge of the availability of low cost service options. See, e.g., Lyndon B. Johnson School of Public Affairs, The University of Texas, Policy Research Project Report No. 116, The Evolution of Universal Service in Texas 17 (1995).

^{42/} Act § 254(b)(3).

assistance.⁴³ Most importantly, the identification of an area as "high cost" should not be based on the costs reported by the firms serving or seeking to serve that area. As the Commission well knows, linking high cost funding with company-reported costs tends to weaken a serving firm's incentives to minimize capital and operating costs.⁴⁴

In the Notice, the Commission requests comments on a number of different "proxy" models that may provide an objective, independent basis for identifying particular areas as high cost.⁴⁵ NTIA strongly encourages the Joint Board to consider each of the alternatives discussed in the comments and recommend to the Commission an approach that can be used in lieu of

43/ NTIA concurs with those parties who recommend that the Commission expeditiously phase-out Digital Equipment Minutes (DEM) weighting which, for LECs with fewer than 50,000 access lines, shifts a disproportionate share of their local switching costs to the interstate jurisdiction to be recovered through long distance rates. See Comments of Ameritech at 11-12; Comments of NCTA at 7; Comments of MCI at 5-6; Comments of LDDS WorldCom at 11-12. DEM weighting is not only a policy without a technical justification. See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 10 FCC Rcd 12309, 12313-14 (1995) (Amendment of Part 36). It is also the sort of implicit subsidy that is proscribed by the Act. See, e.g., Joint Explanatory Statement, supra note 36, at 131. Its elimination would likely be followed by a reduction in interstate long distance rates, which would benefit subscribers of LECs that currently receive DEM support. If the phase-out of DEM weighting were to cause sharp increases in local rates, the Commission and State commissions could mitigate the impact through the transitional support program discussed in Section III.C, infra.

44/ Amendment of Part 36, supra note 43, at 12324.

45/ Notice ¶¶ 31-35.